

Major Reform of the Capital Gains Tax Regime effective from 6 April next

As has been widely discussed in the national press, the capital gains tax regime is to be simplified with effect from 6 April 2008. There will be a single rate of 18% applicable to individuals, trusts, and estates, but not companies – these continue to be liable as under existing rules. As this is the lowest ever headline rate of capital gains tax since its introduction in 1965, it comes at a price; some existing reliefs are to be abolished entirely as from 6 April 2008. As a result there will be both winners and losers under the new regime.

Reliefs to be withdrawn

1. Taper relief: the existing rules for tapering gains according to how long an asset has been held will be repealed.
2. Indexation relief: Introduced with effect from 31 March 1982, this relief gives an allowance for inflation between that date and April 1998 but it will cease to be effective for individuals and trustees from next 6 April.
3. Pre-1982 base costs: If an asset was acquired before 31 March 1982 at a higher cost price than the value of the asset on 31 March 1982, gains can currently be calculated by reference to that higher cost price. This will no longer be the case from 6 April next and the 1982 value will apply in all cases, except for companies.

Other changes

Various other reforms to the capital gains tax rules are being made at the same time. For example, at present where a number of shares are sold out of a larger holding which has been acquired in stages, the shares sold are treated as being the latest acquisition(s). This tends to minimise the tax due as earlier acquisitions will probably have a lower cost price. However, this rule is to be abolished as part of the reforms and all the separate purchases forming one larger holding will be pooled for 2008/09 onwards.

The winners

The big winners under these changes are likely to be those holding assets acquired in the last 10 years or so and which are currently classed as non-business assets in the context of taper relief, i.e. quoted investments, holiday homes, and let residential properties. The rate of tax on these will be reduced, in many cases from a top rate of 40% to the new 18% flat rate.

The losers

On the other hand, the current generous taper relief for business assets (which includes shares held by employees in the employing company, furnished holiday lets, shares in and properties let to unquoted trading companies) is to be swept away. This will mean an increase in the effective rate of tax from 10% for higher rate taxpayers at present to the new 18% rate.

Others who will be affected

The loss of indexation relief for assets acquired before 1998 can in some cases be of significant consequence. Where the asset was originally purchased in 1982, indexation will, in approximate terms, double the actual capital gains tax base cost. As a result, the loss of this relief on assets acquired in the 1980s will have a major impact on capital gains calculation, and it will often eliminate any advantage from the new flat rate of tax.

Entrepreneurs relief

In response to the outcry about the unfair effect on those losing out from 6 April next, the Government announced that it will introduce a new, limited relief for certain business assets. Under this relief, these assets will have an effective 10% tax rate for gains up to £1 million; this will be a lifetime allowance and so it may be used to cover a number of different smaller disposals. However, to qualify as a business asset it must either be one used by an individual for the purposes of his/her own trade or profession, or else, in the case of shares in a trading company, the shareholder must be an officer or employee of the company with 5% or more of the ordinary shares; this will mean that most AIM shareholdings will not qualify, nor will most employee shareholdings.

Planning before 5 April

It may be possible for you to take steps to secure those benefits of the current regime before they are withdrawn. For example, indexation relief may be preserved where there is a transfer of the asset concerned from one spouse to the other. The recipient will have an amalgamated base cost going forward of original cost plus the indexation. It is possible to do this whilst keeping the asset in your own name by completing a Declaration of Trust.

Where the new entrepreneurs relief will not be applicable, you may wish to engineer a disposal under the current regime whilst retaining effective ownership of the asset concerned. This can be done by a transfer to a specially designed short term trust. Alternatively, for quoted shares you could sell these and have them immediately repurchased by your husband/wife. In either case the disposal will give rise to a tax liability payable on 31 January 2009.

Parmentier Arthur Group Plc

**90 Long Acre
Covent Garden
London
WC2E 9RZ**

**7 The Waits
St Ives
Cambs
PE27 5BY**

**Tel: 020 7849 3018
Fax: 020 7849 3171**

**Tel: 01480 465522
Fax: 01480 461221**

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